SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1904.

No. 169.

JOHN B. HUMPHREY, PLAINTIFF IN ERROR,

vs.

CHARLES T. TATMAN, TRUSTEE IN BANKRUPTCY OF NELSON H. DAVIS.

BRIEF OF PLAINTIFF IN ERROR.

The defendant in error, Tatman, is the trustee in bankruptcy of Nelson H. Davis. The petition in bankruptcy was filed by said Davis May 23, 1901, and previous to that on March 6, 1899, the said bankrupt gave to the plaintiff in error, Humphrey, a mortgage as security for the sum of $3,000 paid out in behalf of said Davis for the discharge of his debt, and for the discharge of a similar mortgage to Morrill Brothers. The mortgage to the plaintiff, Humphrey, secured future advances, which were made and which increased the amount of the debt to $4,700. The value of the goods was $2,500 at the time of the alleged conversion. The said mortgage to the plaintiff was not recorded. The debtor being in default under the mortgage, the plaintiff, having reasonable cause to believe him insolvent, took possession of the property. Possession was taken by the plaintiff against the expressed wish and the protests of the debtor and without his assistance. Later foreclosure proceedings were begun. According to the decision of the Court, this mortgage was given and received in entire good faith for a valuable consideration, and the rights of the plaintiff to the goods secured by said mortgage are good as against all persons in the world unless the defendant is to be excepted. (See decision of the Supreme Judicial Court of Massachusetts, p. 12 of the record.) The question to be determined is whether under the Bankruptcy Act of 1898 the plaintiff's rights are good as against the defendant.

Wherever the words "plaintiff" and "defendant" are used in this brief, reference is made to the plaintiff in error and the defendant in error.

I.

The plaintiff's writ of error presents a Federal Question.

The case was presented on agreed facts and all questions were open without regard to the pleadings and the whole Bankruptcy Act so far as it had application was under consideration.

Roxbury *vs.* Minot, 114 Mass. 546.
Fay *vs.* Duggan, 135 Mass. 242.

The pleadings set up the statute and rights under it, and the decision of the case necessarily involved its construction.

Green Bay Canal Co. *vs.* Patten Paper Co., 172 U.S. 58.

The plaintiff is entitled to an exemption under the provision of the Bankruptcy Act, Section 67d, which provides that "Liens given or accepted in good faith and not in contemplation of or in fraud upon this act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this act."

The decision of the Court did not protect the rights of the plaintiff under this clause of the statute, and the decision was against its authority.

The plaintiff is further entitled to an exemption under Section 60b. This section provides, "If a bankrupt shall have given a preference within four months before the filing of a petition . . . and the person receiving it . . . shall have had reasonable cause to believe that it was intended thereby to give a preference, it shall be voidable by the trustee." . . .

The provisions for the creditor occupy the principal part of this section, and amount to an exemption by special provision of the statute. Where there are provisions in behalf of both the creditor and the trustee, a decision in favor of either party would be a decision against the authority of that portion of the statute which is for the protection of the other. The decision of the Court in favor of the trustee was a decision against the protection which the plaintiff claims under the first part of this section, and is against its authority.

The same is true with reference to Section 67e, which excepts "purchasers in good faith and for a present and fair consideration."

In all of the sections the "four months" provision amounts to an exemption.

In Belden *vs.* Chase, 150 U.S. 674, it was held that a failure to apply the correct construction of certain navigation regulations

amounted to the deprivation of rights which gave a right to a Writ of Error. This case goes farther than is necessary in the case at bar, for the plaintiff in that case claimed rights indirectly under the regulations. If the bankruptcy statute has been wrongly construed, it is a denial of the plaintiff's rights expressly set out in the statute.

See also the following cases:

Palmer *vs.* Hussey, 119 U.S. 96.
Ker *vs.* Illinois, 119 U.S. 436.
Boyd *vs.* Thayer, 143 U.S. 135.
Wabash R.R. *vs.* Pearce, 192 U.S. 179.
Factors, Etc., Ins. Co. *vs.* Murphy, 111 U.S. 738.
Traer *vs.* Clews, 115 U.S. 528.
Williams *vs.* Heard, 140 U.S. 529.
Bullis *vs.* O'Beirne, 195 U.S. 606.

See also the words in Metcalf *vs.* Barker, 187 U.S. 165,174.

"Where the lien is obtained four months prior to the filing of the petition it is not only not to be deemed null and void on adjudication, but its validity is recognized."

II.

The construction of the Bankruptcy Statute by the Massachusetts Court was erroneous.

The plaintiff is entitled to the protection of the statute.

The decision of the Massachusetts Court was (p. 12 of the record): "The defendant's acquisition of possession of the mortgaged property before the commencement of the proceedings in bankruptcy, and before third persons had acquired liens or rights by attachment or otherwise, gave him a title which was good at common law against creditors, and which would have been good against an assignee in bankruptcy under the United States Bankruptcy Act of 1867."

The plaintiff should have the same protection under the act of 1898 as the act of 1867 gave.

The mortgage had stood for more than two years unrecorded, and possession had been taken about three weeks before the filing of the petition.

First. It was necessary to take possession of the property to make the mortgage effective against others than the parties thereto. The demands of the local law were, however, satisfied by the possession taken and the possession related back to the delivery of the mortgage, and made it good from the beginning.

Mitchell *et al. vs.* Black *et al.*, 6 Gray, 100.
Chase *vs.* Denny, 130 Mass. 566.

The law of the State is accepted as to the validity of the mortgage.

Etheridge *vs.* Sperry, 139 U. S. 266, 277.
Haskell *vs.* Merrill, 179 Mass. 120.

Second. The intent of the Bankruptcy Statute with reference to unrecorded mortgages is found in Sections 67a and 67e. This is the section which applies to the case at bar, and not 60a and 60b.

Section 67a would not defeat this mortgage, because at the time of filing the petition the possession taken made the mortgage good as against creditors.

The last part of 67e reads, "And all conveyances, transfers, or incumbrances of his property made by a debtor at any time within four months prior to the filing of the petition against him, and while insolvent, which are held null and void as against the creditors of such debtor by the laws of the State, Territory, or district in which such property is situate, shall be deemed null and void under this act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the assignee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt."

The possession taken by the plaintiff, although within the four months, satisfied the local law and therefore satisfied Section 67e. Invalidity under these clauses can be cured at any time before filing the petition.

It is important to note that the statute here recognizes the existence of transfers which are good between the parties and void as to creditors, and after four months they are held good under all the sections of the statute except 67a. Having stood for four months, it could be dealt with as though valid as to creditors and taking possession was not prohibited by the statute.

The error which the Massachusetts Court made was in considering that the transaction must stand for four months in a form valid as to every one, but it was wrong not to recognize a mortgage transfer, which was perfectly good between the parties, merely because it could be defeated by creditors intervening with attachments or the like. As stated *In re* Antigo Screen Door Company, 123 Fed. R. 249, "A law which declares an instrument valid between parties, but void as to creditors, means that it is voidable as to creditors who choose to attack it. Being valid against the parties, it is valid against the world, except those who assail it upon the grounds permitted by law."

And this mortgage was also valid before possession taken as against wrong-doers.

Mass. R. L., Chap. 198, Sect. 1.
Pratt *vs.* Harlow, 16 Gray, 379.

And before there was any intervening creditor or purchaser, it was made good even as to them by the possession taken and the words used *In re* N.Y. Economical Printing Company, 110 Fed. R. 514, are applicable. "The bankrupt act (1898) does not vest the trustee with any better right or title to the bankrupt's property than belongs to the bankrupt or his creditors, at the time when the trustee's title accrues. The present act, like all preceding acts, contemplates that a lien good at that time against the debtor and as against all of his creditors shall remain undisturbed."

Note also the words in First Nat. Bank of N.K. *vs.* Pa. Tr. Co., 124 Fed. R. 968. "The lien acquired Aug. 30, 1901, had not been lost because no rights of third parties intervened. The bank under its contract had a right of possession to the billets as security for the payment of the debt and could not be held guilty of securing a preference by exercising that right within four months preceding bankruptcy.

Third. There was no preference under 60a.

Section 60 refers wholly to transfers by the bankrupt. Whether a transfer is a preference or not depends upon whether what the bankrupt did at the time it was done operated as a preference.

When the mortgage was given, an equivalent was taken which was a full consideration. Such transactions are not preferences.

Jaquith *vs.* Alden, 189 U.S. 78.

The mortgage was an effective transfer as against the bankrupt at the date of the delivery and must be considered as a transfer of property, within the meaning of the statute, even though not valid as to intervening creditors. It did not stand as a preference, but was simply voidable by attaching creditors because not recorded, which invalidity is treated of in Sections 67a and 67e.

Taking possession by the mortgagee was not a transfer, but was the exercise of a right which was given him by the previous transfer. The bankrupt took no part in it and it was not done in the exercise of any power of attorney.

But even if the transfer should date "from the acquisition of possession," the transfer is not thereby separated from its consideration, but the whole transaction, paying of the consideration as well as the delivery of the mortgage, must be considered as having been made together just as they in fact occurred.

The transfer was complete and the plaintiff took possession of his own property and not of the property of the bankrupt.

In re Antigo Screen Door Co., 123 Fed. R. 249.
First Nat. of N.K. *vs.* Pa. Tr. Co., 124 Fed. R. 968.
In re N.Y. Economical Printing Co., 110 Fed. R. 514.
Sabin *vs.* Camp, 98 Fed. 974.
Deland *vs.* Miller & Cheney Bank, 119 Ia. 368.

Fourth. But if it were a preference, which it was not, it could not be recovered under Section 60b because there was no "reasonable cause to believe" that it was intended as a preference.

The fact of the "intent" is not one of the agreed facts and if it is not a necessary inference, which must be made as a matter of law, then there was no such intent.

Kaufman *vs.* Tredway, 195 U.S. 271.

It appears by the agreed facts that the bankrupt protested against the taking of possession and did not assist in it. Possession was taken by the plaintiff as a right and was submitted to by the bankrupt because it would have been illegal for him to do otherwise. Since an equivalent was received, there was no preference when the mortgage was delivered and no wrong intent. The bankrupt was not insolvent when the mortgage was given. The bankrupt intended to give *security* and not a *preference*. The recording and taking of possession are always acts of the mortgagee and follow the act of delivering the mortgage. If to do these things is to make a preference, no mortgage could ever be given which would not be a preference, for whether the time between the delivery and the recording or taking possession is a minute or a year, it makes no difference in principle.

This transaction would not have been an act of bankruptcy under 3a (2).

The decisions of the United States Supreme Court show that the intent is a material consideration in 60b and that more than "the result obtained by the creditor" is thought of.

Pirie *vs.* Chicago T. & T. Co. 182 U.S. 438.
Wilson *vs.* Nelson, 183 U.S. 191.
Metcalf *vs.* Barker, 187 U.S. 165.

"In order to constitute a preference the debtor must do some act to facilitate the proceedings; submissive inactivity is not enough."

Johnson *vs.* Anderson, 11 Am. B.R. 294, 302.

Fifth. The transaction did not occur within the four months.

It is admitted that the original transfer was good between the parties and it must therefore be recognized as a transfer of property, within the meaning of the statute at the time the mortgage was delivered.

The transfer would not have been treated as a preference under 60a and 60b, if possession had not been taken; why should it be so treated after possession was taken? The four months mark the limit of the trustee's power to attack a transaction for illegality of this kind, where the transfer is good between the parties, and this four months

cannot be prolonged by further acts of the creditor with reference to the same matter.

The Massachusetts Court says (p. 14 of the record): "The transfer dates . . . from the acquisition of possession under the mortgage."

The Court relied upon the authority of Wilson *vs.* Nelson, 183 U.S. 191, and drew an analogy from Sections 3a and 3b of the statute.

From Wilson *vs.* Nelson this conclusion was drawn (p. 13 of the record): "It was held that in determining the time of an alleged act of bankruptcy it must be deemed to have occurred when something open and notorious was done affecting the debtor's estate."

After a careful examination of the case, the plaintiff fails to find anything to justify this statement. That decision was based upon the use of the words "suffered and permitted" and the omission of the words "with intent to give a preference."

No analogy can be drawn from Section 3b. The fact that provision is there made that the time shall not expire till four months after "notorious, exclusive or continuous possession is taken" and is omitted in other sections is in itself an argument that the other sections were not intended to operate in the same way.

There is a wide difference in the meaning of the statute provision and the conclusion which the Court drew.

The statute expression is: The time shall not expire till four months from the time of taking possession.

The Court's expression is: The transaction dates from the acquisition of possession.

The first form does not change the relation of the facts, and, if the transaction as at first made was not a preference, taking possession has no effect. Taking possession is treated merely as notice of the previous transaction.

The second form considers the facts out of the order of their occurrence, separates the transfer from its consideration, treats the taking of possession as in itself a wrongful act and claims a preference by a mere juggling of dates where none existed before.

Under Section 3a (2) this transaction was not an act of bankruptcy and the taking of possession would not make it such by force of the provision of Section 3b.

The Massachusetts Court speaks of (p. 14 of the record) "the proceedings by which the mortgagee obtained his lien three weeks before the filing of the petition."

A mortgage is sometimes spoken of as a "lien" because it is security for a debt, but it is in the nature of an equitable lien which exists without possession, which is not true of a pledge, for it is admittedly good between the parties before possession is taken. The above expression by the Court must not be taken to mean more than was intended,— it means simply that the mortgage was made effective as against attaching creditors or the like, three weeks before

filing the petition, but does not deny the existence of the transfer or lien as between the parties before that time.

In this case, whether the property taken was owned by the bankrupt at the time of giving the mortgage or was after-acquired property, makes no difference, and the agreed facts do not show that any after acquired property was taken. The Massachusetts Court considered it as a mortgage of property owned at the time of the delivery of the mortgage.

The distinction between a mortgage and a pledge is clear in Massachusetts, the first being a transfer of title and the other being merely a transfer of possession, while the general title remains in the pledgor.

Walker *vs.* Staples, 5 Allen, 34.
Thompson *vs.* Dolliver, 132 Mass. 103.
Harding *vs.* Eldridge, 186 Mass. 139.

The lien did exist for more than four months before possession taken, although it was voidable as to attaching creditors and the four months provision, as a statute of limitations, made it valid as to the trustee under every section of the statute except Section 67a.

An unrecorded real estate mortgage does not differ materially from an unrecorded chattel mortgage. Such a mortgage was held good from the date of delivery, though not recorded till within the four months.

Pratt *vs.* Christie, 95 App. Div. (N.Y.) 282 (12 Am. B. R. 1).

A deed made within four months in pursuance of a previous agreement was held good.

Murray *vs.* Beal, 23 Utah, 548.

Sixth. Taking possession by the mortgagee, which was done some time before foreclosure proceedings were begun, was in no sense a "legal proceeding" or a "suit or proceeding at law or in equity" under Sections 67c and 67f.

The lien was created by the acts of the parties and not by a legal proceeding. The lien began in the transfer and was perfected as to creditors by possession.

Seventh. The property would not pass to the trustee under 70a, which only gives "the title of the bankrupt as of the date he was adjudged a bankrupt."

Hewit *vs.* Berlin Machine Works, 194 U.S. 296.

Eighth. Section 67d clearly exempts the plaintiff's mortgage.

The decision of the Massachusetts Court and the agreed facts show that the mortgage was given in good faith. At the time when the

mortgage was in fact given and accepted, it was given as security and not in fraud upon the act under the theory of all parties. At the time the mortgage was given and accepted the consideration was a present one, the recording was not necessary to give notice, because possession could be taken to serve that purpose, and possession was taken which related back to the giving of the mortgage. The transaction then should receive the protection of the Bankruptcy Act.

Ninth. Under the Act of 1867 the transaction would have been legal and not a preference.

Gibson *vs.* Warren, 14 Wall, 277.
Sawyer *vs.* Turpin, 91 U.S. 114.
Clark *vs.* Iselin, 21 Wall, 360, 372.
Steward *vs.* Platt, 101 U.S. 731.
Hauselt *vs.* Harrison, 105 U.S. 401.

The sections of the Act of 1867 corresponding to Section 60b are in effect the same.

R. St. U.S., Sect. 5128 and Sect. 5129.

Tenth. While some cases are found seemingly deciding the question against the plaintiff's contention, many of them must be read with reference to the local law and can be distinguished.

Reference is also made to cases cited in the brief printed below.

WM. H. BROWN,
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Below is printed a copy of the brief which was filed in the Supreme Judicial Court of the Commonwealth of Massachusetts, and a certified copy of which is filed as a part of the record of this case.

COMMONWEALTH OF MASSACHUSETTS, } ss.:
Worcester. }

Supreme Judicial Court.

CHARLES T. TATMAN, Trustee. }
vs. }
JOHN B. HUMPHREY. }

Defendant's Brief.

1. The facts having been agreed upon, necessary inferences only can be drawn.

Mayhew *vs.* Durfee, 138 Mass. 584.
Collins *vs.* Waltham, 151 Mass. 196.
Swarz *vs.* Boston, 151 Mass. 226.
Rand *vs.* Hanson, 154 Mass. 87.

2. The plaintiff makes his principal complaint that the mortgage was not recorded. Recording, however, would not have helped so far as after-acquired property was affected.

Blanchard *vs.* Cook, 144 Mass. 207.

There is no provision in the Bankruptcy Statute of the United States which requires mortgages of personal property to be recorded. We must examine the Massachusetts statute and the construction of that statute by the Massachusetts cases to see whether there is any illegality because of the failure to record the mortgage and in the defendant's act of taking possession of the property covered by the mortgage.

Folsom *vs.* Clemence, 111 Mass. 273.
Haskell *vs.* Merrill, 179 Mass. 120.

Previous to the statute it was not necessary to record a mortgage, or to take possession of the property to be protected against third persons.

Holmes *vs.* Crane, 2 Pick. 607.
Wright *vs.* Tetlow *et al.*, 99 Mass. 397.

A mortgage is valid which gives a power to sell in the ordinary course of business.

Fletcher *vs.* Powers, 131 Mass. 333.
Blanchard *vs.* Cook, *ubi supra.*

A mortgage to secure future advances is valid.

The Commercial Bank *vs.* Cunningham, 24 Pick. 270.
Codman *et al. vs.* Freeman, 3 Cush. 306.
Barnard *vs.* Moore *et al. and tr.*, 8 Allen, 273.

A mortgage which covers after-acquired property is valid.

Bennett *vs.* Bailey, 150 Mass. 257.
Bliss, *assignee vs.* Crosier *et al.*, 159 Mass. 498.
Chase *et al. vs.* Denny, 130 Mass. 566.

The fact that the mortgage is not recorded does not make it invalid.

Folsom *vs.* Clemence, 111 Mass. 273.

The act of taking possession relates back to the time of the execution of the mortgage.

Mitchell *et al. vs.* Black *et al.*, 6 Gray, 100.
Chase *vs.* Denny, *ubi supra.*

Taking possession of property under a mortgage made previous to the four months, whether recorded or not, would not be a preference.

See cases, *ubi supra.*

3. The bankruptcy act does not affect a mortgage given in good faith for a present consideration, though not recorded, where recording is not necessary, whether made before or within the four months.

Bankruptcy Law 1898, Sect. 67, cl. d.

This provision is merely negative and does not state what liens or transfers are invalid. The consideration which was given at the time of making the mortgage, and which was afterwards increased, was a present consideration for the whole transaction. No separate consideration was necessary at the time of taking possession. The taking of possession almost always follows, or may follow, the making of the mortgage. It would seem to be immaterial whether the time that elapses between the date of delivering the mortgage and of taking possession of the property is a day or a year.

Since the conveyance was not made by the bankrupt within four months, Sects. 60 and 67 of the bankruptcy act have no application.

The taking of possession was entirely an act of the defendant, the bankrupt took no part in it. A careful reading of the above sections

shows that the bankrupt must himself have done something within the four months in order to make a preference, or an invalid lien, otherwise it would be invalid for a mortgagee under any mortgage to take possession of property within the four months.

Pirie *vs.* Chic. Title & Tr. Co., 182 U.S. 438.
Wilson *vs.* Nelson, 183 U.S. 191.
Metcalf *vs.* Barker, 187 U.S. 165.

4. This bankruptcy act, so far as it has any application to this case, does not differ from the old bankruptcy act, and under the old act this mortgage, where possession was actually taken, although within the four months, would have passed without question.

Clark *vs.* Iselin, 21 Wall, 360, 372.
Stewart *vs.* Platt, 101 U.S. 731.
Hauselt *vs.* Harrison, 105 U.S. 401.

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